Will Growing Inequality Make Social Security & LTC Financing Fixes Harder?

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2020 Society of Actuaries *Living to 100 Symposium*
January 13, 2020
Topics of Discussion

1. Rising inequality in the United States.


3. Challenges for Funding Social Security.

4. Will More Inequality Make Policy Consensus/Compromise Harder?
U.S. income inequality has grown.

Share of national income: Top 1% vs. Bottom 50% in U.S. and Western Europe, 1980-2016
Income inequality very high in the United States

Gini coefficient

Note: Gini coefficients (disposable income, post taxes and transfers) are based on equivalised incomes for OECD countries, Colombia, Latvia and the Russian Federation, per-capita incomes for other countries, and per-capita consumption for India and Indonesia. Data from 2014 or latest year available.

Source: OECD, DB Global Markets Research

Deutsche Bank
Torsten Slok, torsten.slok@db.com +1 212 250-2155
Inequality has grown, but... policymakers, analysts fighting over how much.

Some measures are more equal than others
United States, income share of top 1%

Pre-tax, %
- Piketty-Saez (2003*)
- Piketty-Saez-Zucman (2018)
- Auten-Splinter
- CBO

Post-tax and transfers, %
- Piketty-Saez-Zucman (2018)
- CBO
- Auten-Splinter

Sources: Emmanuel Saez; Gabriel Zucman; David Splinter; CBO

*Subsequently updated
Govt. programs, taxes have softened impact of cumulative growth in income inequality

Policies have provided relatively more support for bottom 1/5 than for middle 3/5s
CBO expects current policies will result in less reduction in income inequality

CBO forecasts:
- continued rise in inequality,
- income growth skewed toward the top,
- less government support for workers in the middle and bottom.
Growth in U.S. wealth concentration

Wealth is typically much more unequally distributed than income.

Bottom 50% have small amounts or zero net assets.

Source: Congressional Budget Office, using data from the Survey of Consumer Finances, supplemented with data from Forbes magazine's list of the nation's 400 wealthiest people.

The Survey of Consumer Finances is conducted every three years.
More families than ever before have zero or negative non-home wealth

Financial resources: percent with zero or negative non-home wealth

A record high 30% of households have no wealth


Deutsche Bank Research
Torsten Slok, torsten.slok@db.com  +1 212 250-2155
January 2018
Younger generations have smaller and smaller net worth

Mean Net Worth by age group
(Ratio to Overall Mean)

- Under 35
- 35-44
- 45-54
- 55-64
- 65-74
- 75 & over

Drivers of U.S. Inequality

Macro factors include: 1) Globalization, 2) Shift to Capitalism Focused More on Financial Transactions and Arbitrage, Less on Producing Value.

In “Global Inequality: A New Approach for the Age of Globalization,” Branko Milanovic identifies five forces pushing up inequality in the United States:

• The increasing share of national income that accrues to owners of capital.
• Very high and rising concentration of incomes from capital.
• People holding high-paying jobs also often have high capital income.
• The tendency of high-income individuals to marry each other.
• The rising political power of the rich.
Consequences of More Inequality

- A shrinking middle class.
- Lower demand for goods and services. Smaller markets.
- Lower productivity growth.
- Higher personal, corporate, and government debt – a time bomb?
- More stress at the bottom:
  - U.S. life expectancy has stopped rising, fallen a bit.
  - More disease and drug use.
- More political conflict, legislative stalemate.
Challenges for LTC Financing
“How Growing Inequality in the US Makes LTC Financing Reform a Lot Harder”  Karl Polzer & John Cutler, SOA 2020

Based on 2018 Health Affairs Blog (Polzer) “How Growing Inequality Is Altering The Long-Term Care Policy Battlefield, While Tightening The Financing Knot”

• Policy battle for many years:  Progressives favor expanded social insurance  v.  Pro-Market Advocates want to tighten Medicaid eligibility to spur more LTC saving, planning.

• Critical developments:
  • Collapse of the market for LTC insurance.
  • Growing economic disparities:  a “hollowed out” middle class.

• Result: Less ability either to buy LTC insurance or pay taxes for LTC except for people in the roughly top 15-20% of income distribution.
More than half of middle-income seniors won’t have the financial resources to pay for seniors housing and care

• 54% lack sufficient resources with 100% of income and home equity.
• 81% lack sufficient resources with 100% of income.
• Only 19% have sufficient resources.

-- National Investment Center for Seniors Housing & Care - 2019
LTC Financing Reform Challenges

• Where to find the $$?  Who will pay?

• A new flat payroll tax to finance LTC expansion (e.g. Washington state) may be doubly unfair to low-wage workers.
  • It’s regressive – would make it harder for low earners to buy life necessities.
  • Also, benefits provided may replace LTC services low-income and middle class already get under Medicaid (which is financed through more progressive taxes). Half the population has zero or very small amounts of net assets (so, many face little asset spend-down to access Medicaid).

• A progressive tax (e.g., on income) would impact the upper income more.
  • Higher-income people and businesses have the greatest political influence and ability to shape policy.

• LTC ranks a lot lower than many other public spending priorities.

• The trillions need to fix Social Security will trigger similar battles over who will pay.
LTC/Retirement Financing: Finding the Middle Ground

from: “Financing future LTSS and long life through more flexible 401(k)s and IRAs: Exploring Reform Options,” Polzer, 2014, SOA Monograph

**Goal:** Incentivize Personal Financial Responsibility Where Possible; Expand Social Insurance Where Needed

• Expanding “policy bargaining table” to include both LTC risk and retirement security creates opportunity to help different income groups in different ways.

1) **Feds provide catastrophic LTC coverage** (for greater than 3-4 yrs. equivalent of NH costs), which would help almost everyone.
   • Most LTCI doesn’t cover catastrophic costs > 4 yrs. NH cost.
   • Many more people could save enough cover LTC if they knew they only had to cover a few years.
   • Fed $$ could overlay Medicaid.

2) **Bolster Medicaid coverage**, while tightening eligibility for those at the top and loosening it for those near the bottom.
   • e.g., allow poorer beneficiaries keep more income, assets.
   • Make eligibility harder for wealthier (reduce allowable beneficiary home value established in Deficit Reduction Act of 2005.)

• Could improve care quality for those receiving services for long time.
LTC Financing Reform Ideas cont.

3) Change minimum distribution requirements to help reduce longevity, LTC risk.
   • e.g., LTSS/longevity accounts, annuities described in this paper.

What about people with little or no DC savings?

4) Help annuitize retirement savings at favorable yields for small accounts.
   • DC system echoes TIAA-CREF in many ways. But where’s the TIAA?
   • Is a fiduciary organization needed to stabilize payouts, assume greater risk than individuals, especially with low income, assets? Could a “myRA” be a starting point for such an approach?
   • Could significantly augment combined DC/SS income for people at SS mean.

5) *Raise the bottom*: Increase Supplemental Security Income (SSI) to poverty level.
   • SSI provides funds for room, board, and living expenses for the lowest-income aged, blind, and disabled people receiving LTC under Medicaid. SSI levels are currently far below the federal poverty level. (In 2014, SSI = $8,657 annually; poverty level = $11,670.)

6) Cover living expenses and LTC costs for the very old (age >92? >95?)
   • Knowing they will have cover a finite # of years of retirement living will reduce risk. Otherwise, when can a risk-averse healthy person ever retire? Also, may increase $$ available for LTC.

7) Improve participation and consumer education early in life – at the “front end” of the DC system.
Financing Social Security
Fixing Social Security – Who Pays?

• Automatic, across-the-board **20% cuts** in monthly Social Security benefits that will occur if Congress fails to raise sufficient revenue to cover scheduled benefits by **sometime in the mid-2030s**.

**Major options include:**

• Raising payroll tax, lifting payroll tax cap or applying new taxes
• Cutting benefits (e.g., trimming inflation adjustments)
• Raising the retirement age
Growing Inequality Creates New Challenges

Issue 1: Growing inequality has shrunk Social Security’s tax base in two ways.

1) In the U.S., labor’s share of national earnings fell about eight percentage points between 1995 and 2013 – while the share from capital rose. Social Security now relies on labor-income taxes.

2) As wages of lower-income Americans have stagnated, those at the top have grown significantly. As a result, the portion of wage income that Social taxes has dropped by about six percentage points. Unless the tax cap on earnings keeps up with the growing prosperity of those at the top, Social Security’s tax base shrinks as a portion of national income.
Restoring Social Security Solvency without Benefit Cuts

The two policy options below could restore program’s financial health. Taxpayers at the top of the heap would bear most of the burden, but none would end up driving a smaller car or living in a smaller house as a result:

- **Taxing invested capital**: Beginning in 2019, Congress could apply an additional 6.2 percent tax on investment income (which mostly accrues to the wealthiest), gradually extending it from top earners to the middle class. SSA actuaries estimate this policy would close about one third of Social Security’s long-run shortfall.

- **Taxing high-earner income**: Beginning in 2019, Congress could apply the payroll tax to earnings above $400,000, leaving a “donut hole” that would gradually disappear as the current indexed tax cap rises, and provide some benefit credit for newly taxed earnings. This change could close up to two thirds of the program’s long-range shortfall.

“There's a way to save Social Security, but it involves taxing the rich”, Polzer, 2018.
A widening mortality gap: Living to 100 is a worry for the better off. For low earners, not so much.

The National Academy of Sciences compared the 1930 and 1960 birth cohorts and found that life expectancy at age 50 for the bottom fifth of men decreased over 30-year period.

Meanwhile, life expectancy rose for men age 50 in higher-income quintiles.

The life expectancy gap between the bottom and top of the income distribution widened from 5.1 to 12.7 years.
Reversal of the decline in midlife mortality for US white non-Hispanics after 1998

Case and Deaton
U.S. Life Expectancy at age 40 by Income

Health Inequality Project
– Raj Chetty et al
Divergence in life span between high and low earners reduces Social Security’s progressivity

Issue 2: “A Widening Gap in Life Expectancy Makes Raising Social Security’s Retirement Age a Particularly Bad Deal for Low-Wage Earners,” forthcoming, early draft posted on Center on Capital & Social Equity

• Social Security’s long-term financial problems result in part from an increase in average life expectancy driven by wealthier people living longer, and, thereby, collecting more benefits.

• Differential longevity trends have had the effect of raising lifetime benefits for high earners but not for low earners.

• Policymakers should not use funding shortfalls attributable these trends as an excuse to cut benefits alike for those who have gained (high earners) and for those who haven’t (low earners).

Raising the retirement age is a cut in lifetime benefits. More low earners will never collect a cent.
Relative Change in Lifetime Social Security Income between High and Low Earner from Raising the Retirement Age

<table>
<thead>
<tr>
<th>Low earner</th>
<th>High earner: life expectancy gap stays as is</th>
<th>High earner: life expectancy grows 3 more years</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Social Sec. income</td>
<td>$12,000</td>
<td>$36,000</td>
</tr>
<tr>
<td>Life expectancy at age 67</td>
<td>8</td>
<td>14</td>
</tr>
<tr>
<td>Lifetime Social Sec. income</td>
<td>$96,000</td>
<td>$504,000</td>
</tr>
<tr>
<td>Lifetime SS income with 2-year hike in retirement age</td>
<td>$72,000</td>
<td>$432,000</td>
</tr>
<tr>
<td>% change in lifetime SS income from baseline</td>
<td>-25.0%</td>
<td>-14.3%</td>
</tr>
<tr>
<td>Life expectancy assumptions are illustrative</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Center on Capital & Social Equity ballpark estimates
Some Policy Options

• Raise retirement age - but compensate lifetime low income with higher benefits.
• Raise retirement age only over an income threshold (would be hard to justify a cutoff point).
• Raise retirement age in tandem with changes in average life expectancy – but significantly raise minimum benefit (Simpson/Bowles).
• Make benefits generally more progressive.
• Go back to age 65 for those with very low lifetime earnings.
• Require low earners to work fewer years to qualify.
An idea an actuary might like: Separate pools

• Annuitizing Social Security retirement benefits by income blocks of the top 10%, middle 80%, and bottom 10%, rather than in one pool.
  
  • This could shift benefits from top to bottom while leaving the middle largely the same.
  • Groups of workers with shorter expected life spans might collect much larger monthly checks than now. Longer expected life would likely result in smaller checks.
    • Compartmentalizing the mortality risk pool may be difficult to administer and would definitely meet resistance.
    • Modeling variants of such an approach might be a good way to illustrate the differing impacts of both the growing life expectancy gap and raising the retirement age on low and high earners.
Prospects for an Unequal Society
Will more inequality make it harder to shore up LTC and Social Security financing?

A more unequal America may find it harder to achieve the political consensus.

More disparity may result in low-income workers being unable to afford, and high-income taxpayers less willing to pay, the tax increases needed to help a smaller middle class maintain major social insurance commitments.

But who knows? If politically awakened, a larger underclass could be a catalyst in coming to compromise.

The politics are unpredictable in a time of crisis.
Make Every Day Count!

In the long run, we are all dead. – John Maynard Keynes